

# Investing in Knowledge

## The surprising secrets of millionaires



When you think of the average millionaire, what are the images that pop into your head? Caviar? Champagne? Flash cars? Expensive boats and holiday homes on the waterfront?

The 2006 World Wealth Report by Merrill Lynch and business consultant Capgemini found that 8.7 million people in the world hold more than US\$1 million in financial assets (i.e. assets other than property), which is a 7% increase since 2004. Collectively these millionaires represent a mind-blowing US\$33 trillion in assets, with strongest growth coming from emerging economies such as Brazil, South Korea, India, Russia and South Africa.

So who are these people? Well, you may be surprised at the reality:

- They are younger than you think. Mr or Mrs Millionaire's average age is 44 and the average billionaire is only 46.
- In the US, according to Georgia State University, only about 20% of millionaires are born into their wealth.
- While there remains the flashy jet-setting elite who flaunt their assets with posh attire and flashy property, these people only account for around 5% of millionaires in the US and around half of them occupy houses worth less than US\$300,000.

The majority of millionaires are simply

average people who have worked hard, been discerning with their money and lead fairly ordinary lives. So, what are their secrets?

1. Almost all own a small business. While there will always be those who make their wealth as employees of huge corporates, the majority are just hard-working entrepreneurs who start by owning a small business.
2. Those working in unglamorous industries such as commercial printing, drycleaning, jewellery, manufacturing and equipment wholesaling have done extremely well.
3. A few have made it big by developing a revolutionary product or breakthrough technique (something that sets them apart), but the majority have simply worked hard and own fantastic businesses.
4. High net worth individuals globally (particularly in the US and Europe) tend to invest more of their wealth in growth assets, such as shares, private equity and alternative investments (particularly in comparison to New Zealanders), and hold their investments over the long term.

While you may have an image in your head of millionaires living "champagne wishes and caviar dreams", the reality is very different. Most millionaires have simply started their own business, worked hard and made the best of opportunities that came their way (and not spent all their wealth).

Let us know if we can help you become a millionaire!

### Contact

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### Awards for excellence

- Financial Planner of the Year 2004– Alison Renfrew CLU, CFP
- *financial* alert Advisory Practice of the Year 2005 regional finalist

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- How changes to tax laws might affect you
- What is happening economically at the moment?
- What your responsibilities are as a trustee

# Tax changes not finalised but we are on top of it

In case you haven't heard, the Government is proposing to make widespread changes to the taxation of investment income. These changes are designed to smooth out several existing anomalies, but are quite complex and we expect further modifications before coming into effect. As a brief summary:

- If a New Zealand managed fund meets the criteria of becoming a Portfolio Investment Entity (PIE) and invests into New Zealand or Australian equities, they will be exempt from capital gains tax and the tax on income produced will be deducted directly at an investor's marginal tax rate (with a cap at 33%).
- The current 'grey list' (i.e. the selective list of countries, including the UK and Australia, where investments were exempt from capital gains) will effectively be disbanded.
- An individual whose direct offshore share investments are outside of Australasia, and which cost over \$50,000 will be taxed on 85% of the change in value of the

investments plus dividends with a cap of 5% (based on the investments opening market value). However, if the dividends or repatriated proceeds is higher than the 5% cap, then the higher amount will be taxable.

There has been a massive amount of media attention on this 'new' capital gains tax, but in reality it already existed (in various forms) for non-grey list countries and managed funds. The proposals are not final and the capital gains tax on overseas investments in particular will come under extreme scrutiny prior to the scheduled implementation in October 2007.

However, the removal of capital gains for PIEs that invest in New Zealand and Australia is extremely encouraging and will likely mean there will no longer be a tax advantage in investing directly.

Don't worry if you are confused – we are on top of all the changes and will keep you informed every step of the way. Please call us if you would like to discuss how the changes may affect your portfolio.

## Tips for beating the winter blues

1. Drink up! It might be cold, but staying hydrated assists in flushing toxins out of your body.
2. Go bananas – bananas have a beneficial effect on physical, mental and sexual energy.
3. Smile – however badly your day is going, try to see the funny side to something – anything!
4. Write a romantic novel – penning a hot-blooded romp might dispel the chill from your life.
5. Join a dance class – you've seen what it did for Rodney Hyde!
6. Have a massage – it relieves tension, aids relaxation, and also helps the body to recover.
7. Get wet – rub all over with a sponge or loofah to get your circulation going.
8. Buy yourself a small bunch of your favourite flowers – you know you deserve a treat!
9. Indulge in a spot of retail therapy.
10. Give blood – honestly, it's not as bad as you think. One small scratch and the worst is over!

## What is happening economically at the moment?

### 1. Interest rates are unlikely to fall until 2007

The consensus view among most respected commentators is that with current inflationary pressures, we are unlikely to see the Reserve Bank lower interest rates until next year. The important point is there is also widespread opinion that interest rate increases are now unlikely for the foreseeable future.

What does this mean for you?

- If you are refinancing your mortgage, look only at locking it in for one year, but no longer than two years, so that when rates do fall (perhaps at some stage next year), you are not locked in at a higher rate for too long.
- It's a good time to lock into some term investments at today's high interest rates.

### 2. The housing market is slowing but no alarm bells needed

We are seeing continuing signs of a slight weakening in the property sector, but as always, this depends on the sector and location you are talking about. Real estate agents will continue to tell us that everything is rosy, but we believe the market is getting slightly weaker with properties taking longer

to sell and values flattening (or falling in some cases). Given the fundamentals of the market, we do not anticipate a huge crash, but perhaps continued 'softness' throughout the remainder of the year.

### 3. The currency may weaken further

The currency has continued to weaken against most trading partners, with many predicting the NZD/USD may go as low as 54 cents before the end of the year. This means imported goods will continue to become more expensive and petrol prices will increase. So in terms of your portfolio, an allocation to offshore investments remains an excellent idea.

Please contact us if you would like to know how these economic themes can be incorporated into your portfolio.

## life's tip #1:

*"One can never consent to creep when one feels an impulse to soar."* – Helen Keller

- The proposed changes to investment tax laws are complicated and will likely change, but there are also upsides for investors
- Talk to us about repositioning your portfolio around current economic trends

# Be aware of trustee responsibilities

With the massive proliferation of trusts in recent years, it is timely to provide a reminder about the importance of the Prudent Person Rule contained in the 1956 Trustee Act (and more specifically in amendments to the Act in 1988).

The Prudent Person Rule means that trustees making investment decisions need to exercise “the care, diligence and skill that a person of business would exercise in managing the affairs of others”. Some important things you as a trustee need to consider with regard to the trust’s investment decisions are outlined below:

1. The value of the investments are protected against inflation.
2. The investments are diversified to protect capital and minimise risk.
3. The likely amount of income. Will this meet beneficiary needs?
4. The likelihood of capital gain or loss and how this fits with the risk propensity of the beneficiaries.
5. The duration of the trust.
6. Taxation liability.
7. Managing the cash flow needs of the beneficiaries in accordance with the Trust Deed.

A common mistake trustees make is placing all their investments into fixed income investments. This may seem like a sound investment strategy and the allocation could be appropriate for the beneficiaries, however:

- This will often be in conflict with modern portfolio theory, i.e. diversification among different asset classes reduces risk.
- The Act requires trustees to preserve the real (i.e. after inflation) value of the trust and if drawing income, the value of the trust may actually be eroding in real terms.

The importance of this is highlighted by the often quoted, but nonetheless important, Mulligan case (1998) in which the husband left a life interest in his estate to his widow. The trustees (including the widow) invested solely in fixed interest investments from 1965 to 1990.

During that time the value of the trust property assets fell from \$108,000 to \$102,000. If instead, the real value of the estate had been maintained, it would have been worth \$1.368 million at the time of the trial in May 1996.

The court found that the trustees knew the effect inflation was having on the real value of the assets and that they should have diversified into some growth assets. It was not a balanced approach and the court held the trustees negligent.

Please contact us if you would like to discuss how we can best manage your trust’s portfolio to ensure the same thing does not happen to you!



## life’s tip #2:

*“There are only two ways to live your life. One is as though nothing is a miracle. The other is as though everything is a miracle.”* – Albert Einstein

## Some great websites you may not know about

<a href="http://www.pricespys.co.nz">www.pricespys.co.nz</a>	Compares the price of a vast array of electronic goods.
<a href="http://www.wotif.com">www.wotif.com</a>	If you can hold off booking a hotel until just before you leave, you can get some fantastic deals here.
<a href="http://www.houseoftravel.co.nz">www.houseoftravel.co.nz</a>	Why not find the cheapest way to fly to that tropical location?
<a href="http://www.qv.co.nz">www.qv.co.nz</a>	Comprehensive information about properties if looking to buy or sell.
<a href="http://www.wises.co.nz">www.wises.co.nz</a>	The complete guide to help you map your way to your destination.
<a href="http://earth.google.com/">http://earth.google.com/</a>	Find out what your house looks like from outer space (don’t bother on a dial-up connection though!).
<a href="http://www.theonion.com">www.theonion.com</a>	If you want to look at the lighter side of current affairs.

# Insurance premiums – a waste of money?

Do you recall reading in our newsletter for the first quarter of this year the findings of a survey released from AIA about the level of insurance protection New Zealanders have? Or don't have as the case maybe!

When we write a comprehensive financial plan we also review your insurance programme. There is no point in spending 40 years or more to accumulate wealth only to lose it due to a serious illness or accident.

Inevitably, premiums for a recommended insurance plan are far more expensive than most clients expect to pay. A business couple from Invercargill today advised they were happy to be paying \$50 per week for their insurance programme, but even we pay \$350 per week and consider ourselves to be underinsured!

What I know is that paying for insurance is just money down the drain... unless you need to put in a claim. If an unexpected event occurs insurance is wonderful.

On 26 December 2005 a young mother of three from Marlborough was in a car accident which left her a tetraplegic. I asked how long a family in this situation would be likely to stay together and was told a couple of weeks ago that only eight months after this tragedy the family had split up. Terribly tragic. It becomes

a double whammy – first an accident and then the break up of the family unit as an inevitable consequence.

In 1999 I read in the newspaper of a young doctor (aged 31) who had run out of sick leave because of cancer. His wife could no longer work because she was caring for him and their new baby, and he could no longer pay for the mortgage on his home. He died three years later. If only he had talked with us! He could have left his wife with a house, an education plan for his child, and an income to provide for his wife so that she wouldn't have to put her son in day-care if she wanted to care for him full-time.

So many people tell me they don't need insurance because they are healthy. The thing is this is the only time you can purchase insurance.

When I was a young mum I had never heard of insurance and certainly wouldn't have wanted to fork out part of my minimal income to pay for any. It's a natural reaction. Today, I pay for the protection to help us for a "just in case" event and hope it will never happen to us.

Having an appropriate insurance programme in place always involves a discussion about the risks you want to cover, the premium you are willing to pay, and the definitions of disability within the policy. Insurance policies that have low premiums cannot offer the same benefits as those with higher premiums, and it's important you know exactly what you are covered for.

Our job is to explain the different options to you, the different products available and then to massage the benefits to fit the premium you are willing to pay.

Please call us at Lyfords for a review of your insurance programme.

## China – have you considered seeing this place?

The population of China is five times that of the USA - 1.25 billion - and a good half of the Chinese population is keen to have the lifestyle and 'things' that Americans have - TVs, cars, holidays... But can the world's resources meet the demand to dig the minerals from the earth to make and create the goods? To make a car you need copper. To make steel you need energy. Where will the electricity come from for the factories to manufacture the goods? What about pollution controls?

It's scary thinking about the health of the planet with such development. There is also the development in Eastern Europe, India, Asia, and South America to consider.

As an investor it is important you are aware of where you are investing. Should you support an economy that will contribute to the pollution of the planet? How bad is the problem really? You would have a much better understanding if you were to actually visit the country and see the developments.

Would you be interested in taking a trip to China to look at the economy? You could see the growth of the cities and balance that with the history of China by looking at the Great Wall and having a river cruise. If we do it as a group with Lyfords clients the trip would be a tax deductible expense as it is about making an informed choice about where you choose to invest.

If you are interested in going on a tour with Lyfords please let us know. At this stage we are just putting out the feelers. We would be staying at five star hotels as we know a lot of our clients would not like to 'rough it'. Xuan Yu, our support person, would come as our translator too, which means you would get a really great understanding of the culture.

We are thinking of going in May 2007, or possibly May 2009. It would be good to have your feedback. Please email [alison@lyfords.co.nz](mailto:alison@lyfords.co.nz) if you are interested.

### life's tip #3:

*"The ultimate measure of a man is not where he stands in moments of comfort, but where he stands at times of challenge and controversy."*

– Martin Luther King Jr

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